

ORIGINAL

POSTED
29 APR 04 RNG

Madera Utilities, Inc.

***Application for approval of adjusted
schedule of rates and charges for
wastewater services***

Docket No. 2003-368-S

RECEIVED
2004 APR 29 AM 10:56
SC PUBLIC SERVICE
COMMISSION

S. C. PUBLIC SERVICE COMMISSION
RECEIVED
APR 29 2004
RECEIVED
UTILITIES DEPARTMENT

***Direct Testimony
Steve W. Gunter
Audit Department***

Public Service Commission of South Carolina

RETURN DATE: OK RNG
SERVICE: OK RNG

1
2 **TESTIMONY OF STEVE W. GUNTER**

3 **FOR**

4 **THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA**

5 **DOCKET NO. 2003-368-S**

6 IN RE: Madera Utilities, Inc.
7

8 **Q. PLEASE STATE FOR THE RECORD YOUR NAME, BUSINESS ADDRESS**
9 **AND POSITION WITH THE PUBLIC SERVICE COMMISSION OF SOUTH**
10 **CAROLINA.**

11 **A.** My name is Steve W. Gunter. My business address is 101
12 Executive Center Drive, Columbia, South Carolina. I am
13 employed by the Public Service Commission of South
14 Carolina as an Auditor.

15 **Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND YOUR**
16 **EXPERIENCE.**

17 **A.** I received a B.A. Degree in Interdisciplinary Studies
18 with a major in Accounting from the University of South
19 Carolina in 1980. I am a Certified Public Accountant,
20 certified in the State of South Carolina. I have 21
21 years of experience in the auditing profession. Twenty
22 of those years have involved the ratemaking process.

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY INVOLVING MADERA
2 UTILITIES, INC.?

3 A. The purpose of my testimony is to set forth in summary
4 form Staff's findings and recommendations resulting from
5 our examination concerning the above docket. These
6 findings and recommendations are set forth in the
7 exhibits of the Audit Department.

8 Q. I SHOW YOU THIS REPORT WITH ITS ATTACHED EXHIBITS,
9 ENTITLED "REPORT OF THE AUDIT DEPARTMENT, THE PUBLIC
10 SERVICE COMMISSION OF SOUTH CAROLINA, "DOCKET NO. 2003-
11 368-S, Madera Utilities, Inc.". DID YOU AND THE AUDIT
12 STAFF PREPARE THIS DOCUMENT?

13 A. Yes, the report was prepared by me and other members of
14 the Audit Department Staff.

15 Q. (MARK FOR IDENTIFICATION). WOULD YOU PLEASE SUMMARIZE
16 THE CONTENTS OF THIS REPORT?

17 A. As outlined in the report's index, pages 1 through 3
18 contain the Staff's analysis of the report, with the
19 remaining pages 4 through 18 containing the Audit
20 Staff's supporting exhibits. The major part of my
21 testimony will refer to Audit Exhibits A and B entitled
22 "Operating Experience and Operating Margin". Such

1 exhibits, as do all of the Audit Staff's exhibits,
2 utilize a test year ending December 31, 2002.

3 Q. DO YOU HAVE ANY FURTHER EXPLANATION OF AUDIT EXHIBITS

4 A and B?

5 A. Yes, the Audit Staff has prepared these exhibits in
6 compliance with the Commission's standard procedures as
7 to calculating income and operating margin for
8 wastewater companies. A brief description of Audit
9 Exhibits A and B is as follows:

10 Column (1): Represents the Company's per book
11 operations for the test year ended December 31, 2002 as
12 filed by the Company in its application for the
13 requested rate increase. These numbers were verified by
14 the Staff as part of our review of the Company's books
15 and records.

16 Column (2): The Staff's Accounting and Pro Forma
17 Adjustments are detailed in this column. These
18 adjustments were made by the Audit Staff in order to
19 correct or normalize the Company's per book operations
20 and are detailed separately in Audit Exhibits A-1 and
21 B-1, respectively.

22 Column (3): The Staff's computation of the
23 Company's normalized test year prior to the effect of

1 the proposed increase is detailed in this column of
2 Audit Exhibits A and B.

3 Column (4): The Staff's adjustments for the
4 proposed increase as furnished by the Utilities
5 Department and all related tax and expense adjustments
6 that are associated with the proposed increase are
7 detailed in this column.

8 Column (5): The Staff's computation of the
9 Company's normalized test year after the effect of
10 accounting and pro forma adjustments and the effect of
11 the proposed increase and the associated tax and expense
12 adjustments are detailed in this column.

13 Q. YOUR REPORT INCLUDES TWO OPERATING EXPERIENCE AND
14 OPERATING MARGIN EXHIBITS. IS THIS DIFFERENT THAN THE
15 NORMAL STAFF REPORT?

16 A. Yes, it is different.

17 Q. WHY HAS THE STAFF CHOSEN TO SHOW TWO OPERATING
18 EXPERIENCE AND OPERATING MARGIN EXHIBITS?

19 A. This rate request is not similar to most rate requests
20 that come before this Commission. The Company has
21 requested the Commission grant rate relief based on a
22 set of circumstances that has not actually taken place.
23 As a result, the Staff was of the opinion that two

1 exhibits would be required to present the data. First,
2 the Commission Staff used historical data and adjusts
3 this data for any known and measurable changes. Next the
4 Commission Staff adjusts the data as if the set of
5 circumstances has taken place.

6 **Q. PLEASE ELABORATE ON THE POSSIBLE CIRCUMSTANCES.**

7 A. According to the Application, DHEC has mandated in
8 Administrative Order 01-214-W dated September 27, 2001,
9 and confirmed by an Administrative Law Judge under
10 Docket No. 01-ALJ-07-0468-CC that the Company eliminate
11 its discharge into Eighteen Mile Creek in Pickens
12 County, South Carolina and that the wastewater be
13 diverted to the wastewater treatment facilities of
14 Pickens County or the City of Clemson. The Company, due
15 to the exorbitant cost of connecting to the County of
16 Pickens, is not seriously considering this option.
17 Audit Exhibit A of my report is based on known and
18 measurable changes to test year operations and shows the
19 operating experience and operating margin under current
20 conditions since none of the above changes have taken
21 place and currently it is not known when or if they will
22 occur. Under this assumption there would be no
23 expenditures to connect to the City of Clemson.

1 Audit Exhibit B shows the Company's proposal to
2 interconnect with the City of Clemson, S.C. As a result,
3 the waste would be transported by the Company through
4 the use of a lift station to the City where the waste
5 would then be treated. This exhibit includes projected
6 expenses for a proposed interconnection with the City of
7 Clemson, S.C., per an engineering report prepared by the
8 Engineering firm of B.P. Barber & Associates, Inc. It
9 should be noted that none of these expenses have been
10 incurred and Staff is including Audit Exhibit B as
11 information only for the Commission's consideration.
12 This scenario is similar to the record in J.C. Cox
13 Utilities' last rate case before the Commission in
14 Docket #2003-277-S.

15 Under this proposal, the Company would retire its
16 existing lagoon, build a lift station and make needed
17 repairs to the existing sewer lines at a cost of
18 approximately \$298,000. This interconnection would also
19 affect operating and maintenance and general and
20 administrative expenses.

21 The addition of the lift station and upgrades to the
22 Company's plant in service would be the result of a DHEC
23 administrative order and would increase the Company's

1 depreciation expense and interest expense for purposes
2 of computing income tax expense and operating margin.

3 Q. DOES THAT CONCLUDE YOUR COMMENTS CONCERNING THE NEED
4 FOR TWO DIFFERENT OPERATING EXPERIENCE AND OPERATING
5 MARGIN EXHIBITS?

6 A. Yes, it does.

7 Q. WHY HAS THE STAFF PROVIDED TESTIMONY REGARDING THESE
8 PROPOSALS?

9 A. Staff's position in this matter relates to the
10 uncertainty as to the future of this system. At present
11 there is no evidence that the City of Clemson is willing
12 to allow the Company to connect to its sewer system. No
13 credible evidence has been brought forth to indicate
14 that any action is going to take place regarding the
15 interconnection with the City of Clemson and the total
16 actual cost associated with this proposal.

17 Q. WOULD YOU PLEASE ELABORATE ON THE CALCULATIONS IN
18 AUDIT EXHIBIT A?

19 A. As shown in Column (1), per book operations were used
20 by Staff to compute "Net Income For Return" of \$46. This
21 was based on Operating Revenue of \$22,160 less Operating
22 Expenses of \$22,114.

1 In Column (2), the Staff's Accounting and Pro Forma
2 adjustments are presented. These adjustments are shown
3 in more detail in Audit Exhibit A-1.

4 Column (3) presents per book operations as adjusted
5 by the Staff. After such adjustments, the Staff computed
6 a "Net Loss For Return" of \$(6,711). This was the result
7 of Operating Revenues of \$23,730 less Operating Expenses
8 of \$30,441. By using the "Net Loss For Return" as
9 adjusted, the Staff computed a negative operating margin
10 of (28.28)%.

11 Column (4) presents the Staff's adjustments
12 resulting from the proposed increase with the Service
13 Revenue portion of this adjustment being supplied by the
14 Utilities Department. These adjustments are also
15 detailed in Audit Exhibit A-1.

16 Column (5) presents per book operations as adjusted
17 to normalize the test year and after the proposed
18 increase is added to revenue. As a result "Net Income
19 For Return" of \$54,744 was computed by the Staff. Such
20 income was based on Operating Revenue of \$100,886 less
21 Operating Expenses of \$46,142. By using the resulting
22 "Net Income For Return" of \$54,744 the Staff computed an
23 operating margin of 54.26%.

1 Q. WOULD YOU PLEASE ELABORATE ON THE CALCULATIONS IN
2 AUDIT EXHIBIT B?

3 A. As shown in column (1), per book operations were used
4 by Staff to compute a "Net Income For Return" of \$46.
5 This was based on Operating Revenue of \$22,160 less
6 Operating Expenses of \$22,114. By using the resulting
7 "Net Income For Return" of \$46 the Staff computed an
8 operating margin of 0.21%.

9 In Column (2), the Staff's Accounting and Pro Forma
10 adjustments are presented. These adjustments are shown
11 in more detail in Audit Exhibit B-1.

12 Column (3) presents per book operations, as adjusted
13 by the Staff. After such adjustments, the Staff computed
14 a "Net Loss For Return" of \$(10,294). This was the
15 result of Operating Revenues of \$23,730 less Operating
16 Expenses of \$34,024. By using the "Net Loss For Return"
17 as adjusted and the adjusted interest expense of \$8,569,
18 the Staff computed a negative operating margin of
19 (79.49)%.

20 Column (4) presents the Staff's adjustments
21 resulting from the proposed increase with the Service
22 Revenue portion of this adjustment being supplied by the

1 Utilities Department. These adjustments are also
2 detailed in Audit Exhibit B-1.

3 Column (5) presents per book operations as adjusted
4 to normalize the test year and after the proposed
5 increase is added to revenue. As a result, "Net Income
6 For Return" of \$54,655 was computed by the Staff. Such
7 income was based on Operating Revenue of \$100,886 less
8 Operating Expenses of \$46,231. By using the resulting
9 "Net Income For Return" of \$54,655 and the adjusted
10 interest expense of \$8,569 the Staff computed an
11 operating margin of 45.68%.

12 **Q. WOULD YOU PLEASE BRIEFLY DESCRIBE THE OTHER AUDIT**
13 **EXHIBITS IN STAFF'S REPORT?**

14 A. Audit Exhibits A-1 and B-1 present the details of the
15 adjustments to correct or normalize the test year, with
16 Audit Exhibits A-2 and B-2 presenting the Company's
17 customer growth computation. Audit Exhibit A-3 presents
18 the Company's Income Statement and Audit Exhibit A-4 is
19 a presentation of the Balance Sheet.

20 **Q. WHICH ADJUSTMENTS ON AUDIT EXHIBITS A-1 and B-1 IN YOUR**
21 **REPORT ARE THE RESPONSIBILITY OF THE AUDIT DEPARTMENT?**

22 A. The adjustments marked with an (A) are the
23 responsibility of the Audit Department witness and the

1 adjustments marked with a (U) are the responsibility of
2 the Utilities Department witness. The adjustments that
3 contain both an (A) and a (U) denote responsibility of
4 both departments.

5 **Q. WOULD YOU PLEASE EXPLAIN STAFF'S PROPOSED ADJUSTMENTS**
6 **AS SHOWN IN AUDIT EXHIBIT A-1?**

7 A. The Staff proposed eight accounting and proforma
8 adjustments and one adjustment for the proposed
9 increase. **Adjustment No. 1** was made by the Utilities
10 Department to annualize revenues based on year-end
11 customers with the Audit Staff computing a \$13 effect
12 on gross receipts taxes. **Adjustment No. 2** was proposed
13 by the Company to increase operating and maintenance
14 expenses based on estimated increases in operating and
15 maintenance expense. The estimates were based on a
16 trend analysis performed by the Company using the
17 assumption that the upgrade and lift station will not
18 be approved. The Staff did not agree with the
19 adjustment because at the time of my report this
20 adjustment was not based on known and measurable
21 increases to operating and maintenance expense.
22 **Adjustment No. 3** was proposed by both the Staff and
23 Company to recognize rate case expenses. Staff's

1 adjustment amortizes actual rate case expenses of
2 \$11,000 over 5 years while the Company's adjustment is
3 based on estimated expenses and the expensing of this
4 total in the test year. The Company's last rate case
5 occurred approximately 14 years ago. In Staff's
6 opinion, 14 years is an unreasonable time period to use
7 for amortizing rate case expenses. The use of a 5 year
8 amortization period appears to Staff to be both fair
9 and reasonable to the Company and ratepayers. Such a
10 time period would spread the cost in an equitable
11 manner to all parties involved in the case.

12 **Adjustment No. 4** was made by the Company to record the
13 yearly payments of principal and interest on borrowed
14 funds the Company says are needed to upgrade an aging
15 system and to build a lift station to tie into the City
16 of Clemson. Staff made no adjustment based on the fact
17 that these funds have not been obtained as of the date
18 of our report and, regardless, would not be allowable
19 as an operating expense. If the loan amount was known,
20 Staff would only include the annualized interest in the
21 computation of income taxes and the operating margin
22 using the interest synchronization method.
23 Additionally, the Staff would allow depreciation

1 expense on any plant items bought with such borrowed
2 funds. **Adjustment No. 5** was made by the Company to
3 include unpaid attorney's fees incurred prior to the
4 test year. The Staff did not accept this adjustment
5 because the fees were for a lawsuit that was not
6 related to the test year and possibly could be
7 nonrecurring. **Adjustment No. 6** was made by the Staff
8 and the Company to recognize an increase in the monthly
9 customer service fee charged by the City of Clemson
10 from \$1.00 per customer per month to \$5.50 per customer
11 per month for servicing the billing, collection and
12 administration of the individual customer accounts and
13 for sending the aggregate sewage flow data to the
14 county. Staff's and Company's adjustments differ due to
15 staff's use of a revised year-end customer count.
16 **Adjustment No. 7** was made by the Company to increase
17 General and Administrative expenses for management fees
18 accrued for past years but not yet paid due to the lack
19 of funds. The Staff did not adjust current year
20 expenses for management fees incurred in prior years
21 because it would be a prior period expense and
22 therefore not related to the test year. **Adjustment No.**
23 **8** is proposed by the Company to record management fees

1 accrued but not paid in the current year due to the
2 lack of funds. Staff has been unable to verify the
3 duties performed in support of the management fee and
4 therefore did not propose an adjustment. It is the
5 responsibility of management to provide any and all
6 evidence to support an adjustment and at the time of my
7 report no such evidence had been provided to support
8 the Company's proposal for a management fee. However,
9 if such evidence is testified to by the Company's
10 witness and the Commission approves such an adjustment
11 as being allowable, the Staff would agree with the
12 Commission's decision. **Adjustment No. 9** is proposed by
13 the Staff and Company for the effects of the proposed
14 increase as computed by the Commission's Utilities
15 Department. Staff's adjustment also proposes to adjust
16 gross receipts tax and income taxes for the effects of
17 the proposed increase.

18 **Q. WOULD YOU PLEASE EXPLAIN STAFF'S PROPOSED ADJUSTMENTS**
19 **AS SHOWN IN AUDIT EXHIBIT B-1?**

20 The Staff proposed nine accounting and proforma
21 adjustments and one adjustment for the proposed
22 increase. I will discuss the adjustments that differ
23 from Exhibit A-1 only. **Adjustment No. 3** was made by

1 Staff to reduce operating and maintenance expenses which
2 will be eliminated with the installation of a lift
3 station and connection to the City of Clemson. A list of
4 expenses that will be eliminated was furnished to the
5 audit staff by the Utilities Department and include the
6 wages of the operator, chemical expense and lab costs.

7 **Adjustment No. 5** was made by both the Staff and the
8 Company to record the effects of borrowing the needed
9 funds to upgrade an aging system and to build a lift
10 station to interconnect with the City of Clemson.

11 The Company's adjustment included the yearly payments of
12 principal and interest on borrowed funds the Company
13 says are needed to upgrade the system and to build a
14 lift station to tie into the City of Clemson. Staff's
15 adjustment is based on preliminary construction cost
16 estimates submitted by the engineering firm of B.P.
17 Barber & Associates, Inc. for the City of Clemson, dated
18 December, 2002, less the contingency fee of \$16,000,
19 which Staff does not recognize for ratemaking purposes.
20 The contingency fee was included to cover unidentified
21 expenses at the time of the agreement. Staff amortized
22 the projected portion of the construction cost assigned
23 to the lift station totaling \$118,000 over 15 years and

1 the remaining \$180,000 for projected repair costs over
2 40 years. The Utilities Department supplied the
3 amortization rates.

4 Q. WOULD YOU PLEASE EXPLAIN THE STAFF'S CUSTOMER GROWTH
5 EXHIBITS A-2 and B-2?

6 A. Yes. The Staff computed a customer growth factor of
7 0.89% for both Exhibit A-2 and Exhibit B-2. Staff,
8 however, used year-end customers and the present flat
9 rate of \$17.50 to annualize revenues, in lieu of using
10 the customer growth factor.

11 Q. DO YOU HAVE ANY RECOMMENDATIONS CONCERNING THE
12 COMPANY'S RECORD KEEPING PRACTICES?

13 A. Staff noted that the Company was not keeping its books
14 in accordance with the NARUC chart of accounts. It is
15 Staff's recommendation that the Company begin recording
16 its revenues, expenses and other transactions using the
17 NARUC chart of accounts for water and wastewater
18 companies.

19 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

20 A. Yes, it does.